Equal Credit Opportunity Act (ECOA), which prohibits discrimination in the provision of business as well as consumer credit. To assist in that work, CFPB will consolidate these functions. The Bureau enforces the core statutes that protect borrowers and other consumers from unfair or deceptive financial products.

Small Businesses are Key Drivers of Economic Growth

Small businesses are a primary driver of job growth and wealth creation in the United States. Providing more than half of the nation’s jobs and two-thirds of net new jobs,[1] they employ half of the nation’s private sector workforce—a 120 million people—and are responsible for creating the majority of the nation’s net new jobs since 1995.[2] Small firms are powerful drivers of innovation; they employ more than 40 percent of high-tech workers in the U.S. and produce 13 times more patents per employee than larger firms.[3] They also reinvest their profits in the local economy, causing “ripple effects” that lead to higher employment rates, greater investment in infrastructure, and more vibrant communities[4]—and communities better able to withstand economic downturns.[5]

Not only do they create more jobs than their larger counterparts, but small, independent businesses also circulate a greater share of every dollar in the local economy. Local small businesses are more likely, for example, to buy goods and services from local sources, hire local employees, and pay taxes to local and municipal governments. By retaining their wealth locally, small businesses create a “virtuous cycle of local spending” that results in more tax revenue, more jobs for residents, and more investments in infrastructure and education.[6] Not surprisingly, compared to big-box retailers, communities with small businesses have stronger local economies, characterized by higher income growth, lower levels of poverty, and more employee retention during economic downturns.[7]

Furthermore, small businesses’ ownership itself can be an important avenue of economic mobility and wealth creation.[8] Business equity represents one-fifth of total household wealth nationwide, making it the second largest source of wealth beyond home equity. Successful entrepreneurship is correlated with wealth, savings, job satisfaction, and upward economic mobility.[9]

Financial Predation Undermines Small Businesses

Small businesses report frequently encountering unfair and deceptive treatment in the financial marketplace. In particular, small businesses express dissatisfaction at the lack of lender transparency and the terms of loans.[10] Researchers have confirmed that opaque and confusing disclosures make it difficult for small-business decision-makers to compare loan offers, denying them the benefits of genuine competition and meaningful choice.[11] Under these conditions, small businesses are paying shockingly high interest rates (over 350 percent in some cases), hindering their capacity to prosper and grow.[12]

Federal Law Inadequately Protects Small Businesses from Financial Abuse

Minimal federal financial protections exist for small business.[13] The Consumer Financial Protection Bureau’s (CFPB) core jurisdiction is limited to financial products “offered or provided for use by consumers primarily for personal, family, or household purposes,”[14] thereby preventing it from using its authority to protect businesses against “unfair, deceptive, or abusive acts or practices” (UDAAPs). Most of the specific statutes the CFPB enforces—such as the Fair Credit Reporting Act,[15] Truth In Lending Act,[16] and the Fair Debt Collection Practices Act[17]—apply only to consumer transactions. These statutes and the CFPB’s UDAAP jurisdiction should be amended to cover transactions with small businesses.[18]

In theory, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the National Credit Union Administration could take enforcement actions against the financial institutions they regulate in order to protect small businesses from “unfair or deceptive acts or practices” (UDAAPs). In practice, these prudential regulators have rarely done so. The Federal Trade Commission has used its UDAAP authority to protect small business against commercial scams perpetrated by non-banks.[19] But it has not used its UDAAP authority to stop unfair or deceptive loans (or the sale of other unfair or deceptive financial products) to businesses.

Congress Should Extend Financial Protections to Small Businesses

There is a strong and growing consensus that small businesses should have stronger federal protections in the financial marketplace. In response to a recent request for information, interested parties “across the stakeholder spectrum” told the Treasury Department that “small business borrowers should receive enhanced protections.”[20] Market participants and small business advocates have recognized that small businesses need and deserve the same treatment that is already required in consumer transactions.[21]

The distinction between a small business borrower and a consumer seeking credit is “often limited,” as a former Administrator of the Small Business Administration has pointed out.[22] Small business owners are typically experts in the products and services they offer, not in finance, and they often have difficulty securing affordable financial or legal advice. For these reasons, small businesses and consumers need the same kind of protections in the financial marketplace.

Moreover, in practice, there is no sharp delineation between consumer financial products and those for small businesses, often putting the personal financial security of individual business owners at risk. Most small businesses are financed with personal assets[23] and 87% of firms use owners’ personal credit scores to secure credit.[24] Even when the business itself takes out a loan, 58% of owners personally guarantee their firms’ debt.[25] In fact, personal guarantees are required for Small Business Administration loans.[26]

CFPB is the Right Agency to Protect Small Businesses

The best agency to oversee protections for small businesses is the CFPB. The CFPB is the primary enforcer of the core statutes that protect borrowers and other users of financial services against misconduct. It can therefore promulgate uniform rules and—with the exception of community banks—supervise and enforce compliance across bank and non-bank financial companies alike.

Moreover, the CFPB already has significant responsibility for small business lending, making it logical to consolidate these functions. The Bureau enforces the Equal Credit Opportunity Act (ECOA), which prohibits discrimination in the provision of business as well as consumer credit. To assist in that work, CFPB will...
soon systematically collect data on small business lending[27] and likely accept complaints from small businesses.[28] These efforts are led by the CFPB’s Office of Small Business Lending Markets, giving the CFPB relevant expertise.[29] Recognizing these advantages, the CFPB’s current director favors expanding the Bureau’s jurisdiction to include transactions with small businesses.[30]

Conclusion

I appreciate your attention to the needs of small businesses and your consideration of this proposal to enact federal protections for small businesses in lending and other financial transactions.

Sincerely,

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cc: House Democratic Whip Office

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[9] See, e.g., Vincenzo Quadrini, “Entrepreneurship, Saving, and Social Mobility.” Review of Economic Dynamics 3 (1): 3 (2000) (finding that families who owned a business at the end of a five-year period but not at the beginning of that period were more likely to have moved into a higher income group than were other families over the same period).


[12] Woodstock Institute, “Analysis of Business Loan Terms” (July 12, 2016), http://www.woodstockinst.org/research/analysis-business-loan-terms (survey of business loans finding effective interest rates up to over 350%, and include junk fees averaging $795


[16] See 15 U.S.C. § 1602(i) (limiting coverage to lending to individuals “primarily for personal, family, or household purposes”).


[18] These statutes could be amended to include any transaction in which an individual is personally liable (including as a guarantor of debt) or a business entity responsible for the debt falls below an established size threshold (for example, one based on a number of employees or annual revenues).


[25] Id.


[27] Dodd-Frank Act § 1071.


[30] Testimony of Richard Cordray, Before the House Financial Service Committee (Mar. 16, 2016) (“[I]f I had my way . . . we would . . . protect not only individual consumers, as our statute authorizes us to do, but also small businesses who often operate in the marketplace with no greater clout than an individual household does. If the Congress sees fit to give us that authority, we will aggressively pursue that. And it would help small business across the country.”).